Reserve Oil and Gas Company

Annual Report 1970

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CLINTON LaTOURRETTE, Los Angeles
Partner, LaTourrette & Co.

LOYD WRIGHT, Los Angeles
Senior Partner, Wright, Rodi, Wright, Tolton & Van Zyl

THE COVER depicts the Arctic Islands area where very large sums of money are being spent on exploration. The two wells shown on the cover mark the discovery of substantial gas reserves at Drake Point and King Christian Island. These are the first two hydrocarbon discoveries in this vast new basin.

ANNUAL MEETING The Annual Meeting of Shareholders will be held at 10:00 a.m. on April 19, 1971 in the Los Angeles Room of the Los Angeles Hilton Hotel. The regular notice and proxy statement will be mailed to Shareholders in advance of the meeting.

EXECUTIVE OFFICES: 550 South Flower St., Los Angeles, California 90017

Geological Reconnaissance in the Northwest Territories.

Financial and Operating Highlights

		1970	1969
FINANCIAL:	Total revenues from continuing operations	$43,448,164	$43,502,895
	Income from continuing operations	3,609,194	3,345,705
	Per common share	.34	.32
	Income (loss) from discontinued operations and extraordinary items	(6,093,287)	1,035,898
	Per common share	(.65)	.12
	Net income (loss)	(2,484,093)	4,381,603
	Per common share	(.31)	.44
	Working capital	10,612,291	9,243,375
	Shareholders' equity	55,017,990	57,988,619
	Total assets	74,010,474	80,007,755
OPERATING:	Crude oil and natural gas liquids production, barrels per day	9,734	9,706
	Natural gas sales, Mcf per day	35,363	40,053

From the President

In 1970 all of your Company's divisions and subsidiaries recorded excellent gains, with the exception of the Hanford Fertilizer Plant.

Continuing Operations. Financial results from continuing operations—covering all of the Company's operations except the Hanford Plant which has been shut down—were at satisfactory levels. Gross revenues from these operations totalled $43,448,164 compared to $43,502,895 for 1969. Income attributable to these operations rose to $3,609,194, up from $3,345,705 for the prior year.

Non Recurring Loss—Hanford Plant. These results were reversed, however, by your Company's decision to shut down the Hanford Plant and withdraw from all phases of the fertilizer business except for the sale of remaining product inventories and disposition of the Plant. The year-1970 loss from these discontinued operations, after the applicable 1970 tax credit, was $715,682. In addition, the Company has written the Plant investment down to $1, resulting in provision for loss on disposition of the Plant of $5,473,533, after a deferred tax credit of $1,876,467.

The resultant net loss for the year was $2,484,093, and although income from continuing operations equaled 34¢ per common share, the Hanford loss and write-down caused a per common share net loss for the year of 31¢ per share. This compares with net income, including extraordinary items, of 44¢ per common share in 1969.

Other financial results for the year were at a satisfactory level. Cash flow from all operations totalled $5,938,354 compared to $6,568,213 in 1969. Working capital at year-end 1970 was $10,612,291 versus $9,243,375 at year-end 1969.

Your Company's major thrust in 1970 to expand its operations in oil and gas exploration and development occurred in Canada. Four extensive projects which were undertaken some months ago and are now in various stages of completion include exploratory drilling in the Northwest Territories, the acquisition of productive properties in Saskatchewan with substantial additional development potential, gas processing plant construction in Alberta and new pipeline construction in Saskatchewan.

An exploratory drilling venture is now in progress just to the south of Great Bear Lake in the Northwest Territories. Early in 1970 a major company committed to the expenditure of not less than $1,200,000 in geophysical work and exploration drilling on this prospect to earn a 50% interest in 1,407,566 working interest acres and 866,528 royalty acres owned by Canadian Reserve. By October 31, 1970, in excess of $850,000 from these committed funds had been spent on geophysical work. A minimum of two exploratory wells will be drilled on these lands during the 1970-71 winter season at an estimated cost of $550,000. The major company will put up the first $350,000 for this

drilling and the balance will be shared equally by that company and Canadian Reserve. The locations of the two initial wells are shown on the Yukon-Northwest Territories map on page 4 of this report. Both wells will be drilled to test Middle Devonian Reef prospects at a projected depth of 3,000 feet. In addition to these wells, other companies have announced plans to drill a minimum of fifteen exploratory wells during this winter season to the south of the Canadian Reserve holdings.

In December of 1970 Canadian Reserve acquired 167,000 net acres for $288,000 in the Manito-Kerrobert area of Saskatchewan and Alberta, to the south of the Lloydminster-Lone Rock heavy crude region. With this purchase the Company also acquired a 50% interest in 12 completed oil wells on these lands, three of which are currently producing. These lands are shown on the map on page 9 of this report. This acquisition substantially increased the Canadian Reserve holdings in this general heavy crude area, which now aggregate working interests in 424,051 gross acres and 190,947 net acres. The original lands in which the Company has varying interests have been developed by 643 gross oil wells, including unit wells representing 220 net oil wells to the Company. An exploratory and development program for 1971 on the wholly-owned and joint interest lands in this heavy crude area has been scheduled at an estimated cost to the Company of $600,000.

The third major Canadian Reserve project was its participation in the construction of a pipeline to transport blended crude oil from the Lone Rock and Marshall areas of Saskatchewan (shown at the very top of the map on page 9 of this report) for a distance of 100 miles south to a junction with the inter-provincial pipeline located at Kerrobert, Saskatchewan. The approximate route of this pipeline is shown on the map. Canadian Reserve will own 40% of this joint venture system at an estimated net cost to the Company of $2,100,000. The system is designed to carry condensate northward and blended condensate-heavy crude southward. The Company's oil and gas holdings in this general area combined with the pipeline ownership, and an increasing demand for asphaltic base heavy crude leading to heavy crude oil price increases in the latter part of 1970, provide a strong foundation for favorable financial returns from these Company interests in 1971 and future years.

The fourth large-scale Canadian Reserve project involves a one-third participation, with a major company, in the construction of a gas processing plant in the Lone Pine Creek area. Canadian Reserve owns a 100% interest in 9,111 acres in this area and is actively developing the D-1 gas reservoir. The new facility will have an initial capacity of 30 million cubic feet of raw gas intake per day.

In January of this year, Canadian Reserve, through an underwriting group headed by Dominion Securities Corporation, Ltd. of Toronto, sold 1 million shares of its common stock to the Canadian public at $6.50 per share. The net proceeds to Canadian Reserve were $6,040,000. There were two principal reasons for this issue: one was the desirability of having equity participation in the Canadian corporation owned by residents of Canada; the second was to provide working capital to Canadian Reserve for its rapidly expanding operations. Your Company has retained an 89.5% ownership position in this Canadian subsidiary company, which has mineral holdings and other properties and interests extending from the U. S.-Canadian border to the northerly portion of the Arctic Islands.

Sales of land in the Apple Valley Ranchos Division were at a substantially higher level than 1969. Aggregate sales, including lands owned by the Company and by others, equalled $3.1 million. This is an increase of 20% from the prior year. Substantial funds are budgeted for 1971 for additional subdivision development, together with modernization and expansion of the Roy Rogers' Apple Valley Inn facility.

The Company's refining and marketing subsidiary, Mohawk Petroleum, had an excellent year in 1970. Sales of gasoline and diesel and stove oils totalled 121,482,800 gallons. In this case also, a substantial 1971 budget has been developed for the Bakersfield refinery and marketing outlet projects.

In October Clinton LaTourrette, who had served on the Board since 1958, resigned as a director in order to devote more time to his other interests. The Board accepted Mr. LaTourrette's resignation with deep regret. In order to retain his valued counsel, he was appointed to the Directors' Advisory Council. Paul D. Meadows, President of Canadian Reserve and a Vice President of the parent company since 1966, was elected to the Board to fill the vacancy.

1970 was marked by the high degree of energy and dedication shown by the Company's personnel. The Board wishes to express its gratification for these efforts. With the broad scope of the Company's exposure in natural resource and land-oriented fields of endeavor, the outlook for renewed growth and profit is highly favorable.

For the Board of Directors

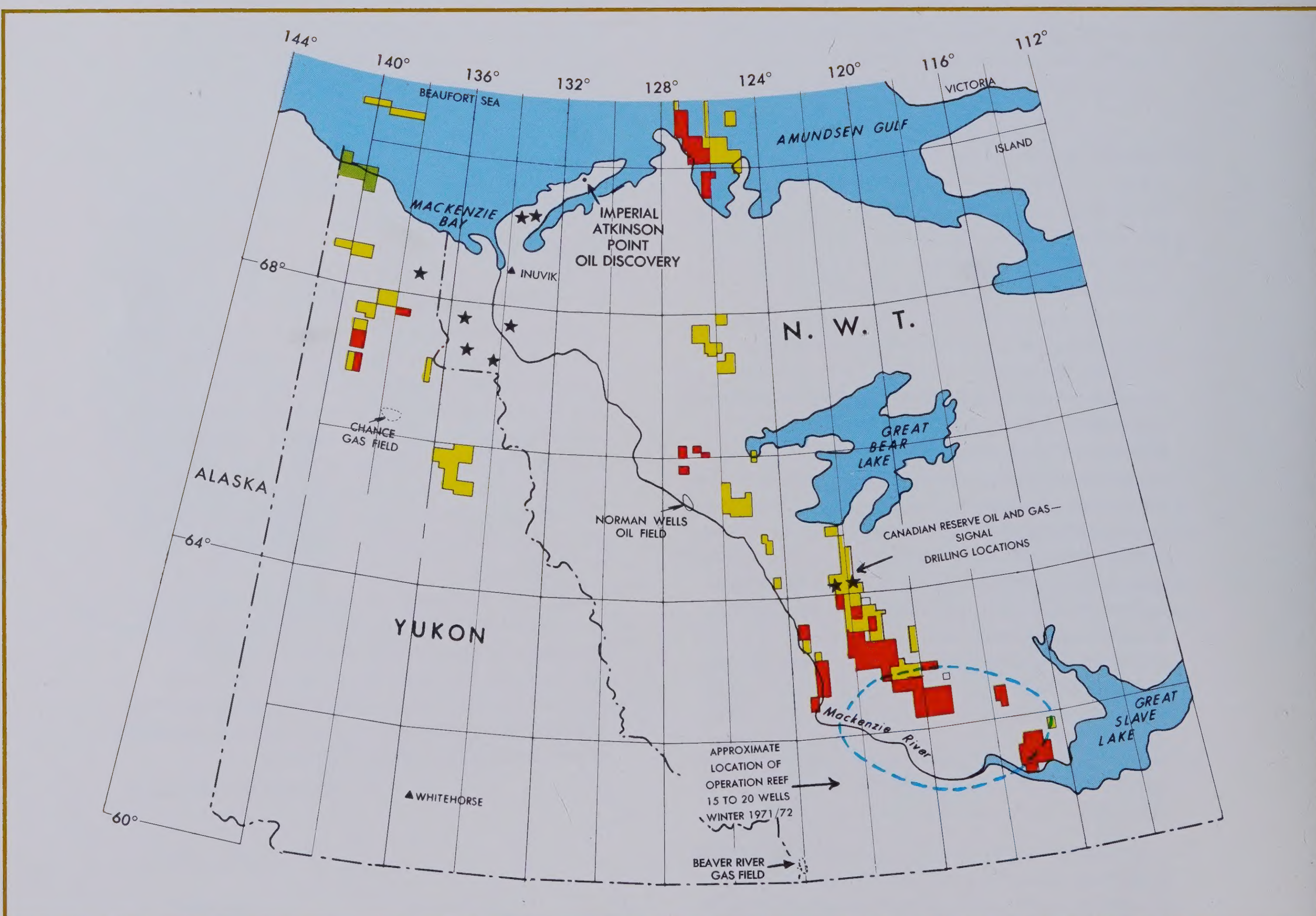
John R. McMillan

President

March 19, 1971

Exploration, Development and Operations

CANADIAN RESERVE OIL AND GAS LTD. On February 8, 1971, Canadian Reserve concluded the sale to the Canadian public at $6.50 per share of 1 million shares of its common stock. Net proceeds to Canadian Reserve from this transaction amounted to $6,040,000, which placed the Canadian company, in which Reserve owns 89.5% of the outstanding stock, in an excellent working capital position to meet its financial obligations, incident to four extensive projects undertaken during 1970. These projects, in various stages of completion at year-end, include expanded exploration activities on Canadian Reserve's vast land holdings in the principal sedimentary basins of Canada, the acquisition of additional productive



YUKON — NORTHWEST TERRITORIES

DECEMBER 31, 1970

100 50 0 100 200

SCALES IN MILES

- 100% WORKING INTEREST
- PARTIAL WORKING INTEREST
- ROYALTY INTEREST
- ★ DRILLING WELLS

WORKING INTEREST
GROSS: 5,290,530 acres
NET: 5,025,730 acres

ROYALTY INTEREST
GROSS: 3,853,445 acres

and potentially productive lands in the heavy crude areas of Saskatchewan, participation in a new sour gas processing plant in Alberta, and participation in a 100-mile heavy crude pipeline in Saskatchewan.

Land — Canadian Reserve holds interests in 22.8 million gross acres and 21.9 million net acres and controls overriding royalties on 5.3 million acres in the Northwest Territories, the Yukon Territory, the Arctic Islands and off the east coast of Canada.

In the Western Canadian provinces of Manitoba, Saskatchewan, Alberta and British Columbia Canadian Reserve holds 1.7 million gross and 615,000 net exploratory acres, in addition to the productive land holdings in these provinces consisting of 268,000 gross and 76,600 net acres.

During 1970, Canadian Reserve, together with a 50% partner, substantially improved its land holdings in the heavy crude oil producing area of Saskatchewan. Total lands acquired in this area amounted to 395,000 gross and 167,000 net acres, all in the area of a 100-mile heavy crude pipeline. In addition, land holdings were increased in Alberta, primarily in known gas areas readily accessible to existing markets. Land acquisitions were also made in northeast British Columbia as a part of Canadian Reserve's increased exploratory activities in this high potential gas area.

In the Arctic Islands three permits were sold totalling 105,055 acres for a total consideration of $105,055, reserving a 3% gross overriding royalty.

Production — Canadian Reserve's production of crude oil and natural gas liquids averaged 5,474 barrels per day in 1970, compared with 5,194 barrels per day in 1969. This increase of 280 barrels per day resulted primarily from increased heavy crude production in Saskatchewan.

Gas sales during 1970 averaged 12,637 MCF/D, down from 15,517 MCF/D in 1969, largely due to a prepayment in 1969 against future gas deliveries. Net gas sales are expected to increase in the fall of 1971 by 5,000 MCF/D upon first deliveries of gas from developed properties in the south Lone Pine Creek field. Net sulphur production amounted to 124 long tons per day, as compared to 113 long tons per day in 1969. Canadian Reserve sold 38,016 long tons of sulphur during 1970 at a net-back price of $(U.S.)7.67 per long ton. This compares to an average price received during 1969 of $(U.S.)18.82 per long ton.

Drilling — In 1970 Canadian Reserve participated as a working interest owner in drilling 64 gross (26.8 net) wells; 21 gross (7.3 net) in Alberta, 4 gross (0.5 net) in British Columbia, 38 gross (19.0 net) in Saskatchewan and 1 gross (0.06 net) in Manitoba. In addition, there were 2 carried working interest and 7 farmout wells drilled to evaluate Canadian Reserve's acreage. Of the 73 wells drilled in which Canadian Reserve participated, 32 were exploratory, 32 were development and 9 were strat tests, which resulted in 28 gross (13.6 net) oil wells, 7 gross (3.0 net) gas wells, 37 gross (11.1 net) dry holes and 1 (0.05 net) suspended well.

Exploration and Development — A summary of Canadian Reserve plans to conduct an extensive program of exploring and developing oil and gas interests is set forth below.

Northeast British Columbia — During 1969 and 1970, Canadian Reserve participated in the drilling of 14 wells in the Blueberry-Inga area, of which 5 were completed as gas wells, 1 indicated gas well was abandoned due to a blowout, 3 were completed as oil wells and 5 were dry holes. Three of the gas wells and the abandoned well established a sour gas field named the North Inga field.

The Inga Sand gas cap area, located immediately north and adjacent to the Inga Unit #1 oil field, was unitized as Inga Unit #3 in July, 1970. Canadian Reserve owns a 7.3% working interest in this unit encompassing 14,750 acres, with indicated gross recoverable gas reserves of 84.5 billion cubic feet. The installation of gas gathering lines and well completions necessary to initiate gas sales of 9.0 million cubic feet per day was in progress at year-end with first sales projected for April, 1971.

Extensive geophysical and drilling operations are presently being conducted by various companies in northeast British Columbia, making the area one of the most active exploration basins in western Canada. Canadian Reserve holds 760,517 gross acres (260,805 net acres) in the area, of which 159,963 gross acres (38,611 net acres) are developed. Canadian Reserve has developed an expanded exploration program for 1971 to search for large gas reserves in Middle Devonian Reefs in the northeast British Columbia area.

Alberta — Canadian Reserve owns 100% interest in 9,111 acres of oil and gas rights in the area east of East Crossfield and south of the Lone Pine Creek sour gas fields, which have been producing from the D-1 and Elkton formations for the past several years. The most significant development wells drilled by Canadian Reserve in 1969 and 1970 are in an area immediately east of the East Crossfield D-1 Unit and south of the Lone Pine Creek D-1 Unit where Canadian Reserve has drilled two D-1 gas wells and one dry hole. Canadian Superior Oil Ltd. has completed four additional D-1 gas wells

in the same area and the two companies have finalized agreements for the construction of a gas processing plant, with an initial capacity of 30 million cubic feet of raw gas intake per day, in which Canadian Reserve will own a 33.3% interest. Construction of these facilities will commence early in 1971 (see Natural Gas Processing). Initial average daily production net to Canadian Reserve's interest is estimated to be 5 million cubic feet per day of sales gas, 80 barrels of condensate and 25 long tons of sulphur.

In the Medicine Hat area of southern Alberta, Canadian Reserve owns an interest in 39,964 gross exploratory acres. A portion of these lands are located in an extension of the Medicine Hat Gas Field where Canadian Reserve participated during 1970 in the completion of 6 gas wells at a depth of 1,400 to 1,700 feet. The remaining undeveloped acreage is scattered through a nearby exploratory area considered to have potential for gas accumulation in the Milk River, Medicine Hat and Bow Island Sands of Cretaceous age at a maximum depth of 3500 feet. Canadian Reserve, in association with a 50% partner, plans to initiate an exploratory drilling program to evaluate these holdings and to obtain interests in additional land during 1971.

Saskatchewan — Your Canadian subsidiary owns 45,359 gross acres (35,431 net acres) of oil and gas rights in the heavy crude oil producing area of Lloydminster and Lone Rock, Saskatchewan, of which 21,819 gross acres (17,618 net acres) have been developed by 643 gross wells, including unit wells, representing 220 net oil wells to Canadian Reserve.

Increased emphasis has been placed on the exploration and development of additional reserves in this area as a result of increased demands for asphalt base heavy crude oil and field posted price increases, effective January 1, 1971, amounting to 40¢ per barrel. Major projects undertaken in 1970 in the heavy crude oil areas called for a 40% participation in the construction of a pipeline to transport blended crude oil from the Lone Rock and Marshall areas of Saskatchewan to a junction with the inter-provincial pipeline system at Kerrobert, Saskatchewan (see Transportation) and for a significant land acquisition to the south of the Lone Rock area with market accessibility to the new pipeline.

The building of the pipeline and increased posted crude prices opened up a new exploratory area for Canadian Reserve from the Lone Rock area to Kerrobert, Saskatchewan. Exploration programs were initiated in 1970 by the drilling of stratigraphic

Drilling in the Northwest Territories.

tests and conventional wells which to date have resulted in finding commercial thicknesses of heavy crude oil sands in three new areas along the pipeline system. Drilling and production testing will continue in 1971 to establish the magnitude of these new discoveries and the productivity of the oil sands. A minimum of 18 net development wells are planned to develop and delineate older reservoirs and new reservoirs discovered as the result of the 1970 exploration program. In addition, Canadian Reserve, in association with partners, plans a drilling program during 1971 of approximately 20 exploratory and 10 stratigraphic test wells in search of new oil reserves.

In addition to expanded exploration and development of primary heavy oil reserves, Canadian Reserve plans to commence secondary recovery

operations by means of water injection on its producing properties in the Lone Rock, Epping and West Epping fields in this area. It is estimated that these secondary recovery operations will increase the amount of oil to be recovered from these fields by approximately 3.7 million barrels.

The South Epping Unit, operated by Canadian Reserve, continues to show additional flood response. The unit, in which Canadian Reserve owns a 52% interest, produced 3,094 barrels of oil per day in 1970 as compared with 2,985 barrels of oil per day in 1969.

Northwest Territories, Yukon Territory and Arctic Islands Area — Canadian Reserve holds 16.8 million gross acres (15.8 million net acres) of exploratory oil and gas rights in the Northwest Territories, Yukon Territory and Arctic Islands area.

During the 1969-70 winter season Canadian Reserve, in association with Signal Oil and Gas Company, completed a gravity and seismic program at an approximate cost of $850,000 on a 2.64 million acre block of Canadian Reserve's land located in the southern plains of the Northwest Territories. The geophysical program was successful in isolating several anomalies on the acreage block and a minimum of two exploratory wells will be drilled this winter to test Middle Devonian reef prospects, equivalent in age to the Rainbow-Zama reefs of northwestern Alberta, at a projected depth of 3,000 feet. In addition, other companies have announced plans to drill a minimum of 15 exploratory wells to the south of the Canadian Reserve holdings in the Northwest Territories during the 1970-71 winter season.

Your Canadian company holds a 100% interest in 1,841,000 acres in the Foothills Fold Belt of the Yukon and Northwest Territories, a geological region which contains known reserves of gas in the Chance area of the Yukon and commercial oil reserves in the Norman Wells area of the Northwest Territories. Canadian Reserve completed a photogeologic study of the area encompassing its holdings and conducted surface geologic evaluations of three of its federal oil and gas permits during 1970. Gravity and seismograph surveys to delineate drillable prospects on mapped surface structures have been programmed for 1971.

Canadian Reserve holds 1,083,000 gross acres (819,000 net acres) in the Arctic Slope trend from the Alaska border to the Amundsen Gulf. The Arctic coastline of the Yukon and Northwest Territories is presently the center of extensive seismic programs, gravity surveys and drilling activities, accelerated due to the discovery of light gravity oil in the Cretaceous Sands at the Atkinson Point well in the Mackenzie Delta. Other operators are currently drilling exploratory wells in the greater Mackenzie Delta area and these wells, together with follow-up Atkinson Point wells, constitute the most active drilling area in the Northwest Territories. Seismic surveys on a portion of the Canadian Reserve holdings in the Amundsen Gulf area have been acquired and an offshore geophysical survey during the summer season of 1971 is planned.

Canadian Reserve holdings aggregate 11.5 million gross acres (10.8 million net acres) in the Arctic Islands area of northern Canada. Extensive exploratory drilling by other operators has been conducted and is continuing through the 1970-71 winter season on the various islands of the Arctic region. Exploratory drilling to date by Panarctic Oils Ltd. has resulted in the discovery of indicated major gas reserves at Drake Point and on King Christian Island. Canadian Reserve has committed 400,000 net acres to the exploratory program operated by Panarctic Oils Ltd., which can earn up to an 85% interest in these committed lands by completing its exploratory operations. During 1970, Canadian Reserve completed an assimilation of all available surface geological data, photogeological information, areal magnetic surveys and gravity and seismic data and plans to conduct gravitymeter and seismic reconnaissance programs on certain of its more promising land holdings during 1971.

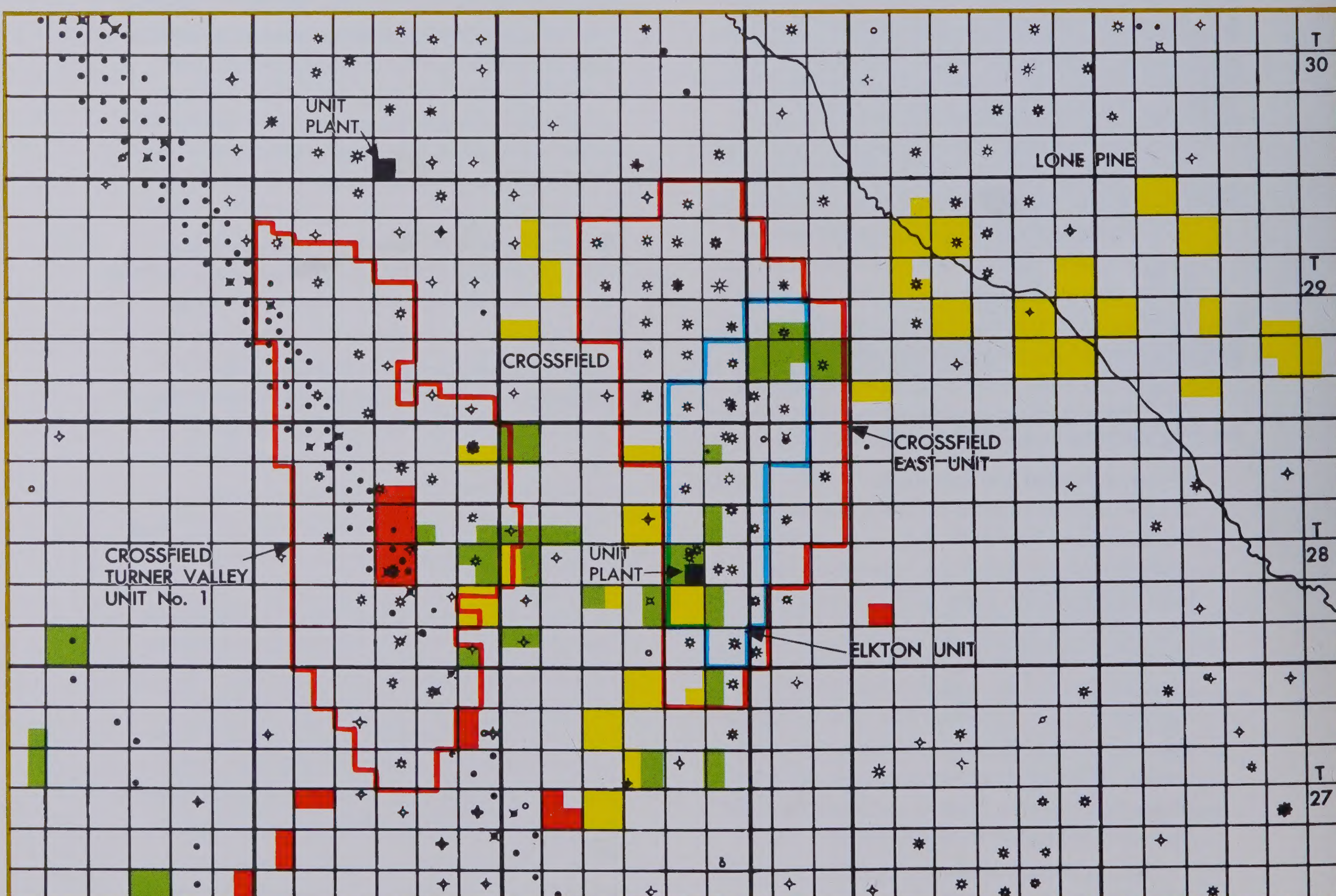
Eastern Canada Offshore — This area offers geological potential for the accumulation of large oil and gas reserves. A discovery would find an immediate market because of proximity to major refining and marketing areas.

A 100% interest in 6.0 million acres in this area is owned by Canadian Reserve, which is planning a marine seismic exploration program on these holdings during the coming year at an estimated cost of $200,000. Major companies are currently conducting extensive offshore exploratory drilling off the east coast of Nova Scotia near Sable Island and in the Maritime Basin north of Prince Edward Island. It is anticipated that exploration activity in the Grand Banks area, the Sable Island area and the Gulf of St. Lawrence will increase in 1971-72.

Heavy Minerals Exploration — During 1970 Canadian Reserve initiated a heavy minerals exploration program and was successful in acquiring claims in the Mayo and Anvil areas of the Yukon Territory, northern Saskatchewan and the southern Northwest Territories.

Transportation — In the heavy crude area of Saskatchewan, Canadian Reserve, in conjunction with Murphy Oil Company Ltd. and another producer, has entered into an agreement for the construction and operation of a pipeline to transport produced heavy crude oil blended with condensate from the Lone Rock and Marshall areas of Saskatchewan 100 miles south to a junction with the inter-provincial pipeline located at Kerrobert, Saskatchewan. Canadian Reserve will own 40% of this joint venture pipeline system, estimated to cost $5,170,000, resulting in a net cost of $2,100,000. The system will carry condensate from the inter-provincial pipeline north to blending plants located at Lone Rock and Marshall, Saskatchewan, for blending with heavy crude oil. The condensate-heavy crude blend will be shipped back to Kerrobert, Saskatchewan to move the blended product, in batch shipments, into the inter-provincial pipeline for delivery into the Ontario and midwestern United States markets. Installation of the pipeline was completed at year-end. The blending, storage and shipping facilities are expected to be completed for pipeline operation in April, 1971, with an initial throughput of approximately 6,000 barrels per day of heavy crude-condensate blend.

Natural Gas Processing — Canadian Reserve has committed for a 33.3% interest in a new Lone Pine Creek sour gas plant which will process gas from the D-1 formation underlying its developed properties in the South Lone Pine Creek field (see map, below). Initial capacity of the plant will be 30 million cubic feet per day of raw gas which may be increased to 40 million cubic feet per day in the event increased capacity is desired. Plant construction and installation of gas gathering facilities, at an estimated net cost to Canadian Reserve of $1,960,000, is scheduled to begin in early 1971,



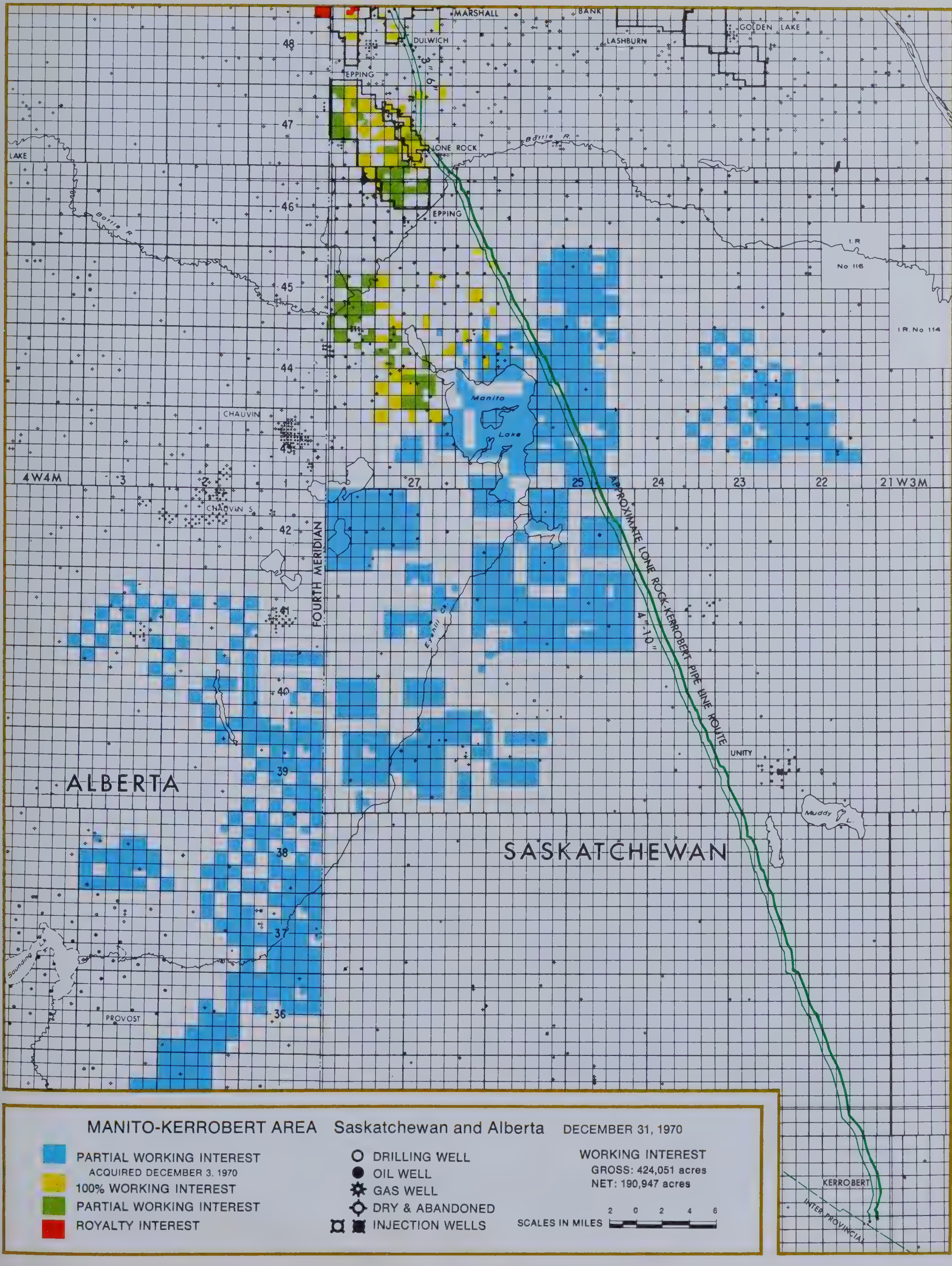
LONE PINE-CROSSFIELD AREA Alberta DECEMBER 31, 1970

100% WORKING INTEREST
PARTIAL WORKING INTEREST
ROYALTY INTEREST

DRILLING WELL
OIL WELL
GAS WELL
DRY & ABANDONED
INJECTION WELLS

WORKING INTEREST
GROSS: 28,173 acres
NET: 19,679 acres
ROYALTY INTEREST
GROSS: 3,520 acres

SCALES IN MILES 1 0 1 2



MARSHALL
BANK
GOLDEN LAKE
DULWICH
LASHBURN
48
EPPING
47
LAKE
LONE ROCK
Battle R.
46
EPPING
Battle R.
I.R. No 116
45
I.R. No 114
44
Manito Lake
CHAUVIN
43
4W4M
3
2
1
27
25
24
23
22
21W3M
CHAUVIN S.
42
FOURTH MERIDIAN
APPROXIMATE LONE ROCK-KERROBERT PIPE LINE ROUTE
4" 10"
41
Eyehill Cr.
40
UNITY
39
ALBERTA
Muddy L.
38
SASKATCHEWAN
37
Sounding L.
36
PROVOST
KERROBERT
INTER PROVINCIAL
MANITO-KERROBERT AREA Saskatchewan and Alberta DECEMBER 31, 1970
PARTIAL WORKING INTEREST
ACQUIRED DECEMBER 3, 1970
100% WORKING INTEREST
PARTIAL WORKING INTEREST
ROYALTY INTEREST
DRILLING WELL
OIL WELL
GAS WELL
DRY & ABANDONED
INJECTION WELLS
WORKING INTEREST
GROSS: 424,051 acres
NET: 190,947 acres
SCALES IN MILES
2 0 2 4 6

to permit initial gas sales in the fall of 1971. A gas sales contract has been completed with Trans-Canada Pipe Lines Limited for the first deliveries beginning November 1, 1971, at an initial contract price of 19.5¢ per MCF.

MID-CONTINENT DIVISION — In 1970 an average of 2757 barrels of crude oil, condensate and natural gas liquids per day and 17,913 MCF of gas per day were produced and sold from the Mid-Continent properties, net to the Company's interest before application to production payments. A total of $2.54 million was applied to principal and $378 thousand was applied to interest on the production payments, leaving a remaining balance of $5.14 million as of January 1, 1971. Economic projections show that the major remaining production payments will be liquidated by September 1972.

Major projects undertaken in this Division during the year are summarized below.

Kansas: Exploratory drilling continues to be active in Western Kansas where your Company owns a one-half leasehold interest in oil rights below 3,400 feet under 19,360 acres and oil and gas rights below 3,400 feet under 2,640 acres located in Finney, Haskell, Kearny and Seward Counties. The Company participated in the drilling of one exploratory well in this area. Although the well was a dry hole, the geological data indicate that acreage in the immediate vicinity may yet prove to be productive. It is estimated that there will be several wells drilled during 1971 in areas where the Company's acreage is located.

Nebraska: The Company, together with other working interest owners, completed engineering work and necessary legal work to initiate two moderate-scale water injection projects in the Kimball area. Water injection is expected to begin by spring of 1971.

New Mexico: The Company, after being elected Operator, took over operations on the effective date of the Cooper Jal Unit containing 95 wells and the South Langlie Jal Unit containing 27 wells. Early commencement of the water injection program on both units is scheduled. Two other unitized projects commenced January 1, 1971, and an additional unit became effective on March 1, 1971. The Company owns working interests in these five units ranging from 0.95% to 40.08%. The formations to be included in these secondary recovery projects are the Yates, Seven Rivers and Queens. Each of these formations has been subject to successful waterflood projects in Lea County, New Mexico.

Texas: The Company-operated GMK (San Andres) Unit located in Gaines County, Texas continued its favorable response to the water injection program into the San Andres Reservoir. In 1970 the Unit produced an average of 1,669 barrels per day as compared to 934 barrels per day at the time the water injection commenced in August, 1968. The Company owns a 34.4% average working interest in this unit and at year-end projected future net oil reserves of 3,690,000 barrels to its interest which will generate a future net income of $9,323,000 over the life of the project.

A 1963 $300,000 mortgage on the Company's interest in the Burnell-North Pettus Gasoline Plant was paid off on October 1, 1970. The elimination of this debt increases the Company's cash flow by over $40,000 annually.

WESTERN DIVISION — CALIFORNIA

Wilmington Field — Reserve participated in drilling or redrilling 3 wells including one producer, one injector and one water source well. Extensive remedial work was done on existing wells to improve secondary recovery performance in both the Fault Block IV and V Units.

Tejon Area — The Company joined in the drilling of 5 wells in the South Central Tejon field. Two were unsuccessful outsteps, one was abandoned, and the other two, 105A and 115A, were completed with initial production rates of 69 and 122 barrels per day, respectively, of 21 gravity oil. Reserve has a 25% interest in these producers.

Mt. View Field — Reserve is participating in a pilot water flood project in this long-productive field to determine if full scale water flooding appears economically practicable.

Vernalis—Banta Station Gas Area — Reserve joined in drilling 3 wells in the recently discovered Banta Station Pool, resulting in 2 producers and 1 dry hole. Great Basins TL&W #1-4 was completed in the Banta Sand with a productive rate established at 2250 MCF per day. Great Basins TL&W #26-9 was completed in the B-1 Sand at an established productive rate of 3350 MCF per day. Reserve owns a 25% working interest in these 2 wells and in 480 acres in the vicinity of the 26-9 well which appear to be highly prospective in the B-1 sand.

ROCKY MOUNTAIN AREA — A total of 12 wells were drilled on Company properties, resulting in 7 producing wells and 5 dry holes.

Desert Springs Gas Field—Wyoming — The Company participated in drilling Unit Well #23, a development well that was dually completed in the Almond and Lewis zones. These were tested at rates up to 3.4 and 4.5 million cubic feet of gas per day, respectively.

Kitty Field—Wyoming — "Reserve Federal" Well Nos. 1 and 2 were completed in this field for initial production rates of 207 and 58 barrels per day, respectively, of 39 gravity oil. Reserve retains a 9½% gross overriding royalty on each well until payout, which then converts to a 50% working interest.

Gibbs Ranch Field—Wyoming — "Reserve Federal" Well Nos. 13-9 and 24-9 were completed for initial production rates, from the Minnelusa zone, of 525 and 58 barrels per day, respectively, of 25 gravity oil. In the first well the Company has a 10% gross overriding royalty until payout and a 50% working interest thereafter. It has a 50% working interest in the second well.

Kaye Field—Wyoming — "Reserve State" No. 31-16 was completed in the Teapot Sand for an initial production of 100 barrels per day of 30 gravity oil. Reserve has a 20% working interest in this well after payout.

HALBOUTY-RESERVE U.S.A. EXPLORATION PROGRAM — Favorable results were achieved by the Halbouty-Reserve Program in 1970. The Program participant has committed an additional $2 million in exploratory funds for 1971.

During 1970 the Program participated in the drilling of 15 new prospects located in Louisiana, Texas, and California, resulting in the discovery of one new gas-distillate pool and two non-commercial gas pools.

In December the No. 1 Edward Istre et al. was completed as the discovery well in the "Het" sand pool of the West Gueydon Field in Vermilion Parish, Louisiana. The well was perforated in the interval 12,067-073 feet, and tested at the rate of 3,500,000 cubic feet of gas and 42 barrels of 47 gravity distillate per day through a 9/64" choke with 7600 psi flowing tubing pressure. The Program owns working interests varying from 33⅓% to 50% in approximately 5,500 acres in the immediate area.

During 1970 three additional development wells were drilled in the Northeast Woodlawn Field in Jefferson Davis Parish, Louisiana, which was discovered in 1969. This makes a total of six producing wells in the field. The program owns a 50% working interest in these wells.

RESERVE-HALBOUTY CANADIAN EXPLORATION PROGRAM — During 1970 ten exploratory wells and one development well were drilled under the Reserve-Halbouty Agreement, including two exploratory wells which had been started in late 1969. One of the exploratory wells, south and east of Calgary, was completed as an Elkton oil well and a second, east of Clarke Lake in British Columbia, was suspended as a potential gas well in the Middle Devonian carbonates.

Reserve-Halbouty participated in two deep-hole tests in the Berland River area of western Alberta in search of gas reserves in the Upper Devonian Woodbend Reef and Beaverhill Lake formations, but these failed to encounter the Woodbend Reef member. One of the abandoned wells, however, established 55 feet of productive zone in the Beaverhill Lake formation which was tested at a rate of 2.55 million cubic feet of gas per day. Reserve-Halbouty owns interests in this area ranging from 5.62% in 1,280 acres and 30% in 1,120 acres of Crown leases; and 12% and 30%, respectively, in two 12,800-acre Drilling Reservations. A previous test, drilled and completed in 1968, established gas reserves in the Wabamun and Beaverhill Lake formations. Another test is programmed for early 1971 in an attempt to determine the extent of these reserves.

The Reserve-Halbouty Canadian Exploration Program was terminated on August 1, 1970. Establishment of a new program is under consideration.

Construction on Lone Rock-Kerrobert pipeline.

Apple Valley Ranchos

Your Company's real estate development business operated by the Apple Valley Ranchos Division in the high desert area of southern California had a very active year in 1970, highlighted by a 20% increase in property sales.

The revenues generated from this business, which includes land sales, commission income from the sale of property for others, revenues from hotel operations and interest income on land sales contracts, totaled in excess of $5 million in 1970. In contrast to the general economic downturn in 1970, your Company's Apple Valley Ranchos Division sales of property, including sales of subdivided property for others under exclusive sales agency contracts, rose to $3.1 million in 1970, up 20% over the comparable sales in 1969.

Your Management is optimistic about the prospects for its investments and operations in Apple Valley. Environmental and ecological problems encountered by the vast urban population of southern California are increasingly responsible for the attention and interest being focused on Apple Valley and the casual spacious "Way of Life" offered in this beautiful valley with its 3,000 foot elevation, clean invigorating air and year-round unsurpassed climate. Apple Valley is in a unique position to take advantage of this interest as a result of the foundation for growth that has been established over the past several years. The community has developed a complete school system through the community college level and has provided its residents with shopping centers, a fully equipped 68-bed hospital, an airport with scheduled airline service and a wide range of recreational attractions.

NEWTON T. BASS, Chairman of the Board

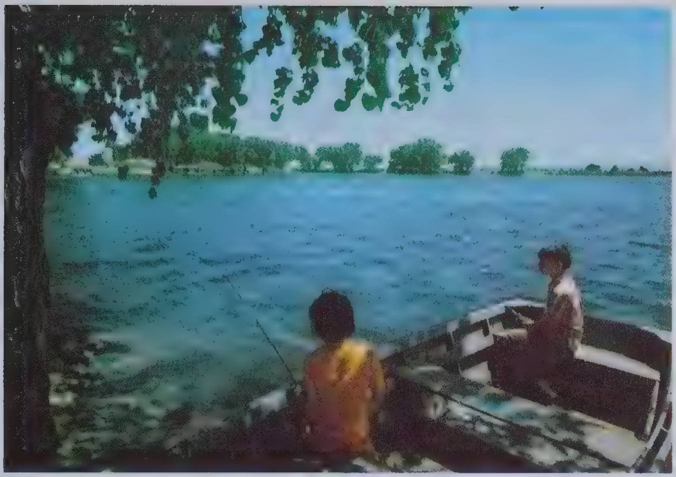
An important facility in the recreational field in Apple Valley is your Company's Roy Rogers' Apple Valley Inn. This well-known resort hotel contains 101 units and offers a variety of activities to its guests including swimming, horseback riding, golf and outdoor steak-frys. In order to update and expand the Inn facilities, your Management has budgeted in excess of $400,000 in 1971 for refurnishing and improvements.

Subdivision development by Apple Valley Ranchos added 304 residential, multiple and commercial parcels to the Company's inventory in 1970, up from 230 parcels developed in 1969. As a result of demand for property in the Company's Desert Knolls Manor No. 1 subdivision, located on a scenic hillside near the picturesque Mojave River Narrows, a third segment containing 132 parcels was opened for sale in March 1970. Later in the year, in May and August, two segments of the new Kiowa Park No. 6 subdivision were placed on sale. This subdivision with 172 parcels is primarily residential and is located within walking distance of the Apple Valley senior high school and junior high school. Work is continuing in other subdivisions in accordance with the Company's master plan for the orderly development of its acreage holdings. It is expected that approximately $1 million will be expended for such development in 1971. Your Company continues to hold approximately 8,000 acres of undeveloped and unencumbered property in the Apple Valley area for future development.

In 1970, the community of Apple Valley welcomed a new and unique business enterprise. General Electric and Del E. Webb Corporation have been awarded a $5.3 million joint venture contract by the U. S. Air Force for the construction of mass-produced modular type housing for Air Force personnel at nearby George Air Force Base. A new 50,000 square foot "housing factory" has been established in Apple Valley for the construction of the various housing units. Full production will require the employment of approximately 125 workers

at the factory. It is expected that the success of this project will establish new concepts in both military and civilian housing across the country.

The construction of Cedar Springs Dam located to the south of Apple Valley progressed through 1970 and was substantially completed in January 1971. This important $25 million facility is a part of the statewide Feather River Water System. The huge earth and rockfill dam is 215 feet high and will impound water in Silverwood Lake which will have a shoreline of 13.4 miles. It is expected that water will begin to fill the lake late in 1971. As a result of passage of a state ballot measure in November 1970, a $6.8 million recreation area will be developed around Silverwood Lake. Present plans call for eleven recreation areas, the most extensive of which will be Sawpit Canyon. This area will have a marina with six boat launching ramps and picnic grounds. Other areas around the lake will have a swimming beach, campsites, camping trailer units, ball fields and an information center. This development, along with plans for recreational facilities in conjunction with the nearby Mojave Forks Reservoir Dam will further the significance of the high desert region and Apple Valley as one of the foremost recreation areas in southern California.



Top—Lakeside fishing is fun in Apple Valley
Left center—Poolside pleasure under the desert sky
Right center—A championship golf course to remember
Bottom—From the Hilltop, a golden panoramic view

Mohawk Petroleum Corporation, Inc.

In its first full year as a wholly-owned subsidiary, Mohawk Petroleum Corporation, Inc., one of California's oldest independent refining and marketing companies, made important contributions to Reserve's operations. Sales of motor gasolines, diesel and stove oils, Mohawk's principal products, totalled 121,482,800 gallons, a slight increase over the previous year. Taxable sales of motor gasolines, averaging 6,646,000 gallons per month, were accomplished by the company's three marketing divisions — the Northern Division headquartered in San Francisco, the Central Division in Bakersfield, and the Southern Division in Los Angeles — through 191 retail outlets, comprising 118 service stations selling Mohawk branded products, 73 rebrand outlets, and approximately 100 commercial customers and wholesale accounts, located in 123 cities and towns throughout the State.

During 1970 a number of new retail outlets were added, including a modern lessee-operated branded unit in the San Joaquin Valley and a large company-operated multi-pump unit complete with automatic car wash and tire store in the Los Angeles Basin. In addition, the company financed construction of 15 remote-control retail rebrand outlets on property owned and operated by Dairy Drive-Ins and Convenience Food Marts. During 1971 Mohawk has projected plans for the installation of approximately 30 additional such retail facilities to be located on properties owned and operated by these small consumer-oriented merchandising businesses. In recent years it has been the company's experience, as the result of continued increases in California land and construction costs, that this relatively new but successful concept of gasoline marketing offers greater returns to the company in relation to investment than the construction and development of conventional service stations.

Mohawk has for years been an important supplier of quality diesel fuel to truck operators, farmers, railroads and other refiners in California. During 1970, as shortages developed in the San Joaquin Valley for this important product, Mohawk sold 40,283,000 gallons, an increase of 14% over the previous year. This increased volume was accompanied by substantial improvement in the price of diesel oil throughout the State, resulting in important increases in revenues and profits from this product.

Under contracts with a major oil company, the United States Navy and numerous independent producers, Mohawk enjoys a dependable and continuing supply of high quality crude to operate its distillation units. During 1970 inputs of crude oil to the company's refinery at Bakersfield, California, which it has owned and operated for 39 years, totalled 5,947,827 barrels, averaging 16,295 B/D, an increase of 4% over the previous year. The company received a license from the Oil Import Administration to import 1,647,610 barrels of crude and unfinished oils during 1970, an average of 4,514 B/D. Mohawk delivered this crude oil at points of importation to a major oil company in exchange for San Joaquin Valley crude oil delivered by pipeline into the refinery.

With its modern Unifiner, Catalytic Platformer, and Ethyl blending facilities, the company has been able to manufacture high quality motor gasolines and other light products meeting the most exacting major company specifications, and accordingly is able to supply its customers with a fully competitive product. Located as it is on the main line of a nation-wide railroad, having direct connections into a common carrier products pipeline to Fresno, and equipped with modern truck loading facilities as well as pipeline connections into other refineries and product distribution facilities in the Bakersfield area, Mohawk has outstanding flexibility in the receiving, handling, blending, shipping and general distribution of gasoline components and finished products.

During 1970 extensive engineering studies were undertaken to develop plans for future refinery modernization and expansion required to meet a growing demand within the refinery's area of distribution, and to provide capability to meet probable environmental regulations affecting fuel composition which may become necessary as a result of state and federal regulations. Mohawk's management faces the challenges posed by a growing environ-

Operating Highlights 1970

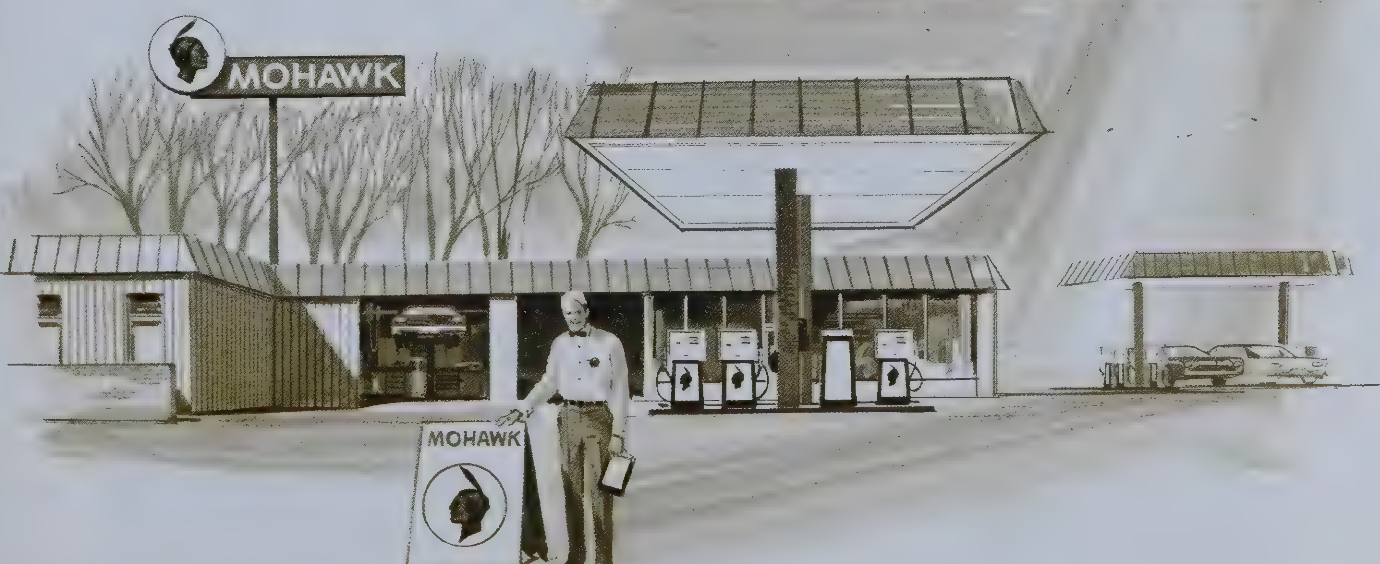
Refinery Thruput	5,947,827 Barrels	16,295 Barrels per Day
Gasoline Sales	79,759,865 Gallons	6,646,655 Gallons per Month
Diesel & Stove Oil Sales	41,722,935 Gallons	3,476,911 Gallons per Month

Retail Products Outlets at December 31, 1970. 191

mental consciousness with confidence that it can meet the demands placed by today's society on the petroleum refining industry.

Consumer interests have long recognized the importance inherent in the existence of a healthy, viable independent refining and marketing segment of the petroleum industry, a concept which has been officially acknowledged by the federal government not only in the interest of the consumer, but in the interest of national security. With its refinery located in California's interior San Joaquin Valley (an area in which 37% of the state's crude oil is produced), connected through pipeline systems to the Elk Hills Naval Petroleum Reserve No. 1, one of the nation's largest developed reserves of crude oil, and situated in the heart of one of the state's most vigorously developing regions, Mohawk looks forward with confidence to continued and profitable participation in the growth of the California gasoline market.

From top to bottom, A Northern California station design; the Bakersfield Refinery; transportation, and a Central California station design.



Financial Review

Your Company's income, before a loss on discontinued operations and extraordinary items, increased to $3,609,194 in 1970 from $3,345,705 in 1969. Income per common share on such amounts was $.34 per share in 1970 and $.32 in 1969.

Your Board of Directors elected to close down the Company's Hanford Fertilizer Plant in December 1970 and, as a result of this action, a provision for loss on disposition of the plant in the amount of $5,473,533 was entered in your Company's statement of operations as an extraordinary item. This provision, coupled with the loss from operation of the plant during the year, more than offset the income from continuing operations and created a net loss for the year of $2,484,093, equal to $.31 per common share. This compares with net income of $4,381,603 earned in 1969, including $1,422,740 of extraordinary credits; the per common share equivalents of which were $.44 and $.16 respectively.

Revenues from continuing operations in 1970 amounted to $43,448,164, down slightly from the $43,502,895 recorded in the prior year. It is significant to note, however, that crude oil purchasers in November 1970, posted price increases which will net your Company approximately $.25 more per barrel in both the United States and Canada.

Costs and expenses from continuing operations declined $318,220 in 1970 due largely to a decline in federal income tax expense of your Company's Mohawk subsidiary. Mohawk incurred federal income tax expense of $653,000 in 1969 prior to the merger and none since, due to Reserve's loss carryforwards and the tax benefits attributable to Reserve's oil and gas operations and discontinued fertilizer business.

Cash flow from all operations in 1970 declined $629,859 from the 1969 level to $5.9 million due to an increase in normal operating, administrative and selling expenses. Capital expenditures totaled $4.8 million, production payment principal applications amounted to $4.2 million and other applications of funds amounted to $1.3 million. Working capital increased $1,368,916 in 1970 to $10.6 million at year-end. This increase is a result of borrowings, both in the United States and in Canada. In Reserve, the Company's primary credit arrangement with a bank was revised to provide a total credit line of $7.5 million. The interest rate is ½% over the prime rate on the amount borrowed and ½% on the unborrowed portion of the credit line. Repayment of the amount borrowed will commence on March 31, 1973 at the rate of $500,000 per quarter with the final payment due December 31, 1975. The amount borrowed at December 31, 1970 amounted to $4,930,000. Canadian Reserve borrowed $2,749,460 in 1970 under notes to a Canadian Bank. These notes were consolidated under a $5.0 million production loan commitment with an interest rate of ½% over the prime rate. Early in 1971, one million shares of Canadian Reserve common were sold to the Canadian public at $6.50 per share. The details of the underwriting are described on page 4 of this report.

Regular quarterly dividends were paid in 1970 on the Company's four issues of preferred stock in the total amount of $427,541. In capital stock activity, 2,650 shares of preferred stock were converted during the year into 7,031 shares of common.

Reserve's Board meeting in the Hilltop Board Room in Apple Valley—clockwise from the foreground, Meadows, Westlund, Hellman, McMillan, Bass, Holloway, Bixby, Green, Ball, Cramer, Aberley, McDuffie and LaTourrette.

Company's Net Share Oil and Gas Sales

1970

	Crude Oil and Natural Gas Liquids—Bbls.	Dry and Casinghead Gas—Mcf
Texas	701,006	5,569,147
California	339,219	1,435,191
Wyoming	201,776	321,083
Nebraska	86,689	—
Louisiana	84,016	—
Illinois	63,065	—
New Mexico	40,658	645,251
Oklahoma	28,144	179,505
Saskatchewan	1,299,362	56,557
Alberta	414,848	4,218,903
British Columbia	185,077	337,131
Manitoba	98,604	—
All Others	10,593	144,560
Totals	3,553,057	12,907,328
Average Per Day	9,734	35,363

NOTE: The above tabulation includes production applied to the retirement of production payments.

Accountants' Report

ARTHUR YOUNG & COMPANY

CROCKER PLAZA
POST AT MONTGOMERY
SAN FRANCISCO, CALIFORNIA 94104

The Board of Directors and Shareholders
Reserve Oil and Gas Company

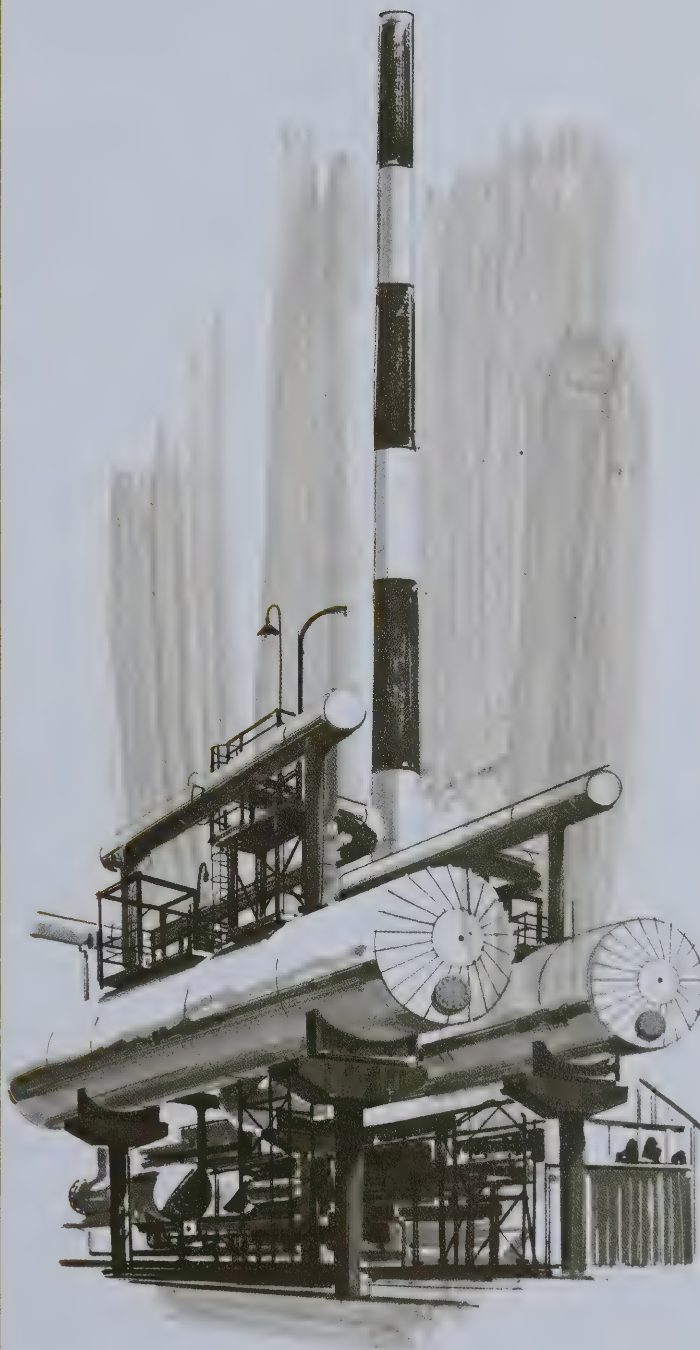
We have examined the accompanying consolidated balance sheet of Reserve Oil and Gas Company at December 31, 1970 and the related consolidated statements of operations and earned surplus, and source and disposition of funds for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We have previously made a similar examination of the consolidated financial statements for the prior year, and have received the reports of other independent auditors with respect to their examination of the financial statements of certain of the Company's subsidiaries for the year ended December 31, 1969, whose assets and revenues represent 37% and 72% of the respective consolidated totals for 1969.

At December 31, 1969 recovery of the Company's investment in the Hanford Fertilizer Plant was uncertain. In 1970 the Company decided to discontinue operations of the plant and provided for a loss on its disposition, as described in Note 9.

In our opinion, based on our examination and the reports of other independent auditors referred to above, the statements mentioned above present fairly the consolidated financial position of Reserve Oil and Gas Company at December 31, 1970 and December 31, 1969 and the consolidated results of their operations and the consolidated source and disposition of their funds for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis during the period.

Arthur Young & Company

February 13, 1971



Portion of proposed gas processing plant at Lone Pine Creek, Alberta, Canada.

Consolidated Balance Sheet DECEMBER 31, 1970, 1969

ASSETS	1970	1969
CURRENT ASSETS:		
Cash—including certificates of deposit, 1970—$1,050,000	$ 3,755,262	$ 3,049,114
Marketable securities, at cost (approximately market in 1970)	1,950,909	2,744,049
Accounts receivable	5,139,875	5,944,899
Installment contracts, commissions and notes receivable	1,677,416	1,836,831
Inventories, at lower of cost or market	2,909,313	3,161,474
Prepaid expenses	916,064	1,017,813
Total current assets	16,348,839	17,754,180
INVESTMENTS AND LONG-TERM RECEIVABLES:		
Installment contracts, commissions and notes receivable	8,407,762	8,288,326
Undeveloped land and other investments, at cost	862,964	1,164,442
Fertilizer plant, at cost, less allowance for accumulated depreciation and loss	1	7,525,681
	9,270,727	16,978,449
PROPERTIES, at cost:		
Oil and gas properties	68,953,903	67,441,425
Refining, manufacturing and distributing facilities	11,094,483	10,850,950
Commercial and other properties	6,152,209	5,540,049
	86,200,595	83,832,424
Less accumulated depletion and depreciation	37,809,687	38,557,298
	48,390,908	45,275,126
	$74,010,474	$80,007,755

LIABILITIES AND SHAREHOLDERS' EQUITY	1970	1969
CURRENT LIABILITIES:		
Notes payable, current portion	$ 111,150	$ 1,000,390
Accounts payable and accrued liabilities	5,539,206	6,078,618
Exchange oil payable	86,192	1,237,586
Federal and state income taxes	—	194,211
Total current liabilities	5,736,548	8,510,805
LONG-TERM LIABILITIES:		
Notes and other long-term payables	8,464,606	4,559,265
Deferred federal, state and Canadian income taxes	500,000	2,476,801
	8,964,606	7,036,066
DEFERRED INCOME:		
Carved out production payments	1,779,450	3,385,314
Commissions receivable	2,511,880	3,086,951
	4,291,330	6,472,265
SHAREHOLDERS' EQUITY:		
Capital stock:		
Convertible preferred stock, $25 par and involuntary liquidating value: 1970—authorized 400,000 shares; issued 311,553 shares (including 2,558 treasury shares)	7,788,825	7,855,075
Common stock, $1 par value: 1970—authorized 15,000,000 shares; issued 9,332,398 shares (including 6,041 treasury shares); reserved for options, conversion of preferred stock and warrants 1,035,249 shares	9,332,398	9,325,367
Capital surplus	14,241,942	14,238,302
Earned surplus	23,706,886	26,618,520
Treasury stock, at cost, 2,558 shares Series B preferred shares and 6,041 common shares	(52,061)	(48,645)
	55,017,990	57,988,619
	$74,010,474	$80,007,755

See accompanying notes.

Consolidated Statement of Operations and Earned Surplus YEARS ENDED DECEMBER 31, 1970, 1969

	1970	1969
REVENUES:		
Petroleum product sales	$37,130,867	$36,829,929
Real estate sales and commission income	3,513,189	3,826,712
Other income—including interest income 1970—$707,049, 1969—$688,232	2,804,108	2,846,254
	43,448,164	43,502,895
COSTS AND EXPENSES:		
Cost of petroleum products sold and operating expenses	25,315,813	25,191,699
Cost of real estate sold and provision for loss on repossessions	1,167,735	1,030,799
Selling and administrative expenses	7,793,825	6,986,945
Dry hole costs	246,397	102,989
Depletion, depreciation and abandonments	3,643,823	3,819,884
Interest expense	1,006,216	1,537,166
Federal and state income taxes	665,161	1,487,708
	39,838,970	40,157,190
INCOME FROM CONTINUING OPERATIONS	3,609,194	3,345,705
Loss from discontinued operations, less allocated tax benefit	(715,682)	(386,842)
INCOME BEFORE EXTRAORDINARY ITEMS	2,893,512	2,958,863
EXTRAORDINARY ITEMS:		
Federal income tax reduction attributable to loss carryforwards	—	393,000
Gain on sale of oil and gas properties—less $594,514 deferred tax 1969; related tax credit 1970	95,928	1,029,740
Provision for loss on disposition of fertilizer plant, less deferred tax credit—$1,876,467	(5,473,533)	—
NET INCOME (LOSS), for the year	(2,484,093)	4,381,603
EARNED SURPLUS, beginning of year	26,618,520	22,651,708
DIVIDENDS PAID ON PREFERRED STOCK	(427,541)	(414,791)
EARNED SURPLUS, end of year	$23,706,886	$26,618,520
PER SHARE OF COMMON STOCK:		
Income from continuing operations	$ .34	$ .32
Loss from discontinued operations	(.08)	(.04)
Extraordinary items	(.57)	.16
Net income (loss) applicable to common stock	$(.31)	$ .44

See accompanying notes.

Consolidated Statement of Source and Disposition of Funds YEARS ENDED DECEMBER 31, 1970, 1969

	1970	1969
SOURCE OF FUNDS:		
Operations:		
Income before extraordinary items	$ 2,893,512	$ 2,958,863
Charges (credits) to income before extraordinary items, not involving working capital:		
Depletion, depreciation and abandonments	4,206,946	4,067,650
Revenue from land sales (not due in one year), less provision for loss on repossessions	(1,446,357)	(1,301,931)
Other	284,253	843,631
Total from operations	5,938,354	6,568,213
Collections on land sales contracts	669,087	717,339
Proceeds from loans	4,223,664	3,000,000
Proceeds from sale of properties	168,067	1,825,183
Other	685,037	65,488
	11,684,209	12,176,223
DISPOSITION OF FUNDS:		
Additions to properties	4,829,711	6,730,521
Principal applications to production payments	4,150,945	4,213,396
Decrease in long-term liabilities	657,894	1,032,399
Dividends paid on preferred stock	427,541	414,791
Other	249,202	783,290
	10,315,293	13,174,397
Increase (decrease) in working capital	$ 1,368,916	$ (998,174)

See accompanying notes.

Notes to Consolidated Financial Statements YEAR ENDED DECEMBER 31, 1970

1. Principles of consolidation. The Company's consolidated financial statements include the accounts of all its wholly and majority-owned subsidiaries. The accounts of Canadian subsidiaries have been converted to U.S. dollars at appropriate rates of exchange. Intercompany transactions have been eliminated.

During 1969, the Company acquired, in poolings-of-interests, the net assets of four oil and gas companies in exchange for 974,924 shares of its common stock, 173,790 shares of its Series D convertible preferred stock, and warrants, exercisable through September 15, 1974, to purchase 107,604 (as adjusted in 1970) shares of its common stock at $13.94 per share (as adjusted in 1970).

In 1971, the Company's wholly-owned Canadian subsidiary issued 1,000,000 new shares of its stock for cash which reduced the Company's ownership to 89.5%.

2. Installment contracts, commissions and notes receivable. Installment contracts, commissions and notes receivable are after deduction of allowance for losses and allowance for uncollectible commissions aggregating $1,727,588 in 1970 and $1,362,183 in 1969. Installment contracts are principally twelve-year notes and are secured by the land sold. Commissions receivable represent commissions earned on sales of land owned by others. As the Company has no enforceable claim against the purchaser or the original owner of the lot, the receivables are offset in the balance sheet by an equivalent amount of deferred income, to be recognized when collected.

3. Inventories. Inventories are as follows:

	December 31	
	1970	*1969*
Petroleum products, at average cost	$1,080,965	$1,179,085
Fertilizer and chemical products at lower of cost or market	639,421	600,733
Subdivided land, at cost	790,350	885,033
Materials and supplies, at or below average cost	398,577	496,623
	$2,909,313	$3,161,474

4. Properties. Reserved production payments are added to the cost of the acquired properties. The unpaid balance of the production payments ($5,143,772 in 1970; $7,688,853 in 1969) is payable solely out of production from the properties and is deducted from the total carrying value. Sales of $3,083,000 in 1970 and $3,247,000 in 1969 and interest expense of $380,000 in 1970 and $522,000 in 1969, which were attributable to production payments, are included in the consolidated statement of operations and earned surplus.

Depletion and depreciation of the costs of oil properties and related equipment are computed on the unit-of-production basis; buildings and other equipment are depreciated by the straight-line and declining-balance methods at rates varying from 2½% to 33⅓% per annum.

5. Notes and other long-term payables. At December 31, 1970 the Company had notes payable to a bank for $4,930,000 under a loan agreement providing for a credit line of $7,500,000 to December 31, 1972 ($500,000 payable quarterly beginning March 31, 1973, with a final installment due December 31, 1975, with interest payable quarterly at ½% above the bank's prime rate). The debt agreement requires, among other things, the maintenance of a minimum net worth (as defined), working capital equal to 10% of defined net worth, and prohibits the payment of cash dividends on the Company's common stock.

In addition, the Company has a $2,749,460 note payable, with interest at ½% above the prime rate, the other terms of which are currently being negotiated. It is expected that the loan will be secured by oil and gas properties and that monthly payments will begin in 1972 based upon production.

Other notes and long-term payables include commissions and compensation payable, notes payable, and 5½% debentures payable, of which $111,150 is due within one year.

6. Federal, state and Canadian income taxes. The liability for deferred income taxes represents estimated taxes applicable to depreciation expense deducted for tax purposes which is in excess of the expense included in the financial statements in 1970 and to installment sales of land and oil and gas properties in 1969. In consolidation, the Company has eliminated $84,000 of deferred Canadian taxes provided by its subsidiary, as other tax deductions are currently available.

It is anticipated that the accumulated earnings of the Canadian subsidiary will be required for use in its operations and, accordingly, no provision has been made for U.S. income taxes (which would be reduced by applicable Canadian tax credits) which may be payable if and when any earnings are transferred to the parent company.

7. Shareholders' equity. The Company has shares of four series of 5½% cumulative, convertible, voting (except Series C), preferred stock outstanding at December 31, 1970 as follows: Series A—23,853, Series B—104,310 (includes 2,558 treasury shares), Series C—9,600, and Series D—173,790. Such shares are convertible into common stock at various rates and are callable by the Company, at various times and at amounts up to 106% of par value.

During 1970, 2,650 shares of preferred stock (3,017 shares in 1969) were converted into 7,031 shares of common stock (7,717 shares in 1969), resulting in an increase in capital surplus of $59,219 ($67,708 in 1969).

The Company has several stock-option plans for officers and other employees, including a plan approved by stockholders in April 1970 reserving 200,000 shares for options, under which options may be granted at the market price at the date of grant, not to become exercisable until at least one year after date of grant. At January 1, 1970, options were outstanding for 206,000 shares of the Company's common stock and 106,000 shares were available for the granting of options. During 1970, options for 18,500 shares were granted, an option for 1,000 shares was cancelled, and an extension of the period in which options for 113,500 shares are exercisable was granted. In addition, the exercise price of the options during the extension period for these shares was reduced from various prices to $8.50 per share. Options for 7,250 shares were exercised at prices aggregating $49,844 in 1969. At December 31, 1970, options were outstanding for 223,500 shares at prices ranging from $5.875 to $17.75 per share, an aggregate of $2,587,822. At that same date, options for 205,000 shares were exercisable and 88,500 shares were available for the granting of future options.

At December 31, 1970, 1,035,249 shares of common stock were reserved for issuance as follows: 615,645 shares for conversion of preferred stock; 312,000 shares in connection with stock options; and 107,604 shares in connection with warrants.

In 1970, capital surplus was charged with $55,579 in connection with 1969 mergers. In 1969, capital surplus was charged $405,733 in connection with mergers and increased by $10,319,457 by the issuance of 899,617 shares of common stock upon conversion of substantially all of its 6½% debentures.

8. Net income (loss) per share. Net income (loss) per share of common stock is based on the weighted average shares outstanding and net income (loss) after deduction of preferred dividend requirements. Assuming conversion of outstanding preferred stock and convertible debentures and exercise of outstanding stock options at the beginning of the year, there would have been no dilution of the per share results.

9. Hanford Fertilizer Plant. At December 31, 1969, the extent of recovery of the investment in the Hanford Fertilizer Plant was dependent upon the successful resolution of technical production problems and subsequent attainment of its profitable operation. Although during 1970 the Company resolved the production problems, the combined impact of continued decline in fertilizer product prices and the additional investment which appeared necessary to market these products in quantities sufficient to make the plant operation profitable was such that the Company decided to discontinue operations. Accordingly, operations of the plant are shown as discontinued and an extraordinary provision for loss (which assumes a salvage value less costs to be incurred during 1971) on the ultimate disposition of the plant has been included in the accompanying consolidated financial statements. Revenues attributable to operations of the plant were $1,390,000 in 1970 and $834,000 in 1969.

Principal Subsidiaries

CANADIAN RESERVE OIL AND GAS LTD.
639 - 5th Avenue, S.W., Calgary 1, Alberta, Canada
Paul D. Meadows, President

MOHAWK PETROLEUM CORPORATION, INC.
550 S. Flower Street, Los Angeles, California 90017
Malcolm McDuffie, President

Division and Other Offices

EXECUTIVE OFFICES:
550 S. Flower Street, Los Angeles, California 90017

APPLE VALLEY RANCHOS DIVISION
P. O. Box 1, Apple Valley, California 92307, Walter E. Cramer, Jr., Vice President

MID-CONTINENT DIVISION
1806 Fidelity Union Tower, Dallas, Texas 75201, Paul D. Meadows, Vice President

WESTERN DIVISION
Route 2, Box 434, Bakersfield, California 93302, Robert P. Mangold, Manager

Transfer Agents

SECURITY PACIFIC NATIONAL BANK, Corporate Trust Division
124 West Fourth Street, Los Angeles, California 90013

THE CHASE MANHATTAN BANK, N.A.
One Chase Manhattan Plaza, New York, New York 10015

GUARANTY TRUST COMPANY OF CANADA, 311 - 8th Avenue, S.W., Calgary, Alberta, Canada
and 88 University Avenue, Toronto 1, Ontario, Canada

Registrars

THE BANK OF CALIFORNIA, N.A.
550 S. Flower Street, Los Angeles, California 90017

FIRST NATIONAL CITY BANK
55 Wall Street, New York, New York 10005

GUARANTY TRUST COMPANY OF CANADA, 311 - 8th Avenue, S.W., Calgary, Alberta, Canada
and 88 University Avenue, Toronto 1, Ontario, Canada

Stock Exchange Listings

American Stock Exchange
Pacific Coast Stock Exchange
Toronto Stock Exchange

Shareholders and Employees

SHAREHOLDERS	21,000
EMPLOYEES	700

AREAS OF PRINCIPAL HOLDINGS OF CANADIAN RESERVE OIL AND GAS LTD.

December 31, 1970

(This map is intended for orientation only. The maps on pages 4, 8 and 9 show the locations of specific oil and gas holdings referred to in this annual report, in which the Company holds the interests stated on the maps.)

Geographical Area	Working Interest Gross Acres	Royalty Interest Gross Acres
Alberta	603,624	312,840
Saskatchewan	135,725	733,041
Manitoba	183,215	—
British Columbia	760,517	57,460
Northwest Territories	3,399,898	3,502,217
Yukon Territory	1,890,632	351,228
Arctic Islands area	11,509,336	1,412,455
East Coast offshore	6,054,289	—
Total	24,537,236	6,369,241